

**Internal Revenue Service**

Department of the Treasury

Washington, DC 20224

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Third Party Communication: None

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B02

PLR-146529-10

Date:

February 17, 2011

X =

State =

D1 =

D2 =

D3 =

Dear :

This responds to a letter dated November 8, 2010, and subsequent correspondence submitted on behalf of X by its authorized representative, requesting a ruling under §§ 1362(b)(5) and 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated in State on D1. It was intended that X elect S corporation treatment effective D1; however, a Form 2553, Election by a Small Business Corporation, was not timely filed for X.

On D2, the shareholders of X entered into a formal Shareholders' Agreement. The adoption of the Shareholders' Agreement may have terminated X's S corporation election by creating a second class of stock. On D3, a corporation purchased X causing X's S corporation election to terminate, if it was not already terminated on D2.

X represents that it did not intend to create a second class of stock and that the possible termination was not motivated by tax avoidance. X also represents that it and its shareholders timely and consistently filed their tax returns consistent with the treatment of X as an S corporation.

## LAW AND ANALYSIS

Section 1361(a)(1) of the Code provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(b)(1)(D) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides that a corporation is generally treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds.

Section 1.1361-1(l)(2)(i) provides that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state law, and binding agreements relating to distribution and liquidation proceeds (collectively, the "governing provisions"). A commercial contractual agreement, such as a lease, employment agreement, or loan agreement, is not a binding agreement relating to distribution and liquidation proceeds and thus is not a governing provision unless a principal purpose of the agreement is to circumvent the one class of stock requirement. Although a corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical distribution and liquidation rights, any distributions (including actual, constructive, or deemed distributions) that differ in timing or amount are to be given appropriate tax effect in accordance with the facts and circumstances.

Section 1362(b) provides the rule on when an S election will be effective. Generally, if an S election is made within the first two and one-half months of a corporation's taxable year, then the corporation will be treated as an S corporation for the year in which the election is made. Section 1362(b)(3) provides that if an S election is made after the first two and one-half months of a corporation's taxable year, then the corporation will not be treated as an S corporation until the taxable year after the year in which the S election is made.

Section 1362(b)(5) provides that if (1) an election under § 1362(a) is made for any taxable year after the date prescribed by § 1362(b) for making the election for the taxable year or no § 1362(a) election is made for any taxable year, and (2) the

Secretary determines that there was reasonable cause for the failure to timely make the election, then the Secretary may treat the election as timely made for such taxable year and § 1362(b)(3) shall not apply.

Section 1362(d)(2) provides that (A) in general, an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation and (B) any termination under § 1362(d)(2) shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation or (B) to acquire the shareholder consents; and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

Based solely on the facts and the representations submitted, we conclude that X has established reasonable cause for failing to make a timely election to be an S corporation effective D1. Accordingly, provided that X makes an election to be an S corporation by filing a completed Form 2553 with the appropriate service center effective D1 within 120 days following the date of this letter, then such election will be treated as timely made for X's taxable year beginning D1. A copy of this letter should be attached to the Form 2553.

In addition, based solely on the facts submitted and the representations made, we conclude that X's S corporation election may have terminated on D2 because X may have had more than one class of stock. However, we conclude that, if X's S corporation election was terminated, such termination was inadvertent within the meaning of § 1362(f). Consequently, we rule that, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D2 to D3, provided X makes a valid S corporation election effective D1 and provided that the election was not otherwise terminated under § 1361(d).

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code. In particular, we express no opinion as to whether X otherwise qualifies as a subchapter S corporation under § 1361.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Bradford R. Poston  
Senior Counsel, Branch 2  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures: 2

Copy of this letter

Copy for § 6110 purposes